

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

**RESULTS OF RECIPIENT AUDIT REPORTS
FOR THE YEAR ENDED DECEMBER 31, 1999**

Report No. AU00-006

September 2000

September 29, 2000

TO THE BOARD OF DIRECTORS
OF
THE LEGAL SERVICES CORPORATION

The Corporation's fiscal year 1996 appropriations statute (Pub. L. No. 104-134) directed that annual financial statement audits be used as the primary means for checking grantee compliance with applicable laws and regulations. The fiscal year 1999 appropriations act (Pub. L. No. 105-277) also included this provision. This report presents the results of the 1999 audits of LSC grantees.

Independent Public Accountants (IPAs) reported 112 findings in the 263 audit reports received. After reviewing these findings the OIG concluded that 56 were significant and referred them to LSC management for follow up. None of the referred findings were for grantee noncompliance with prohibitions and restrictions on the provision of legal services.

Internal control weaknesses such as a failure to follow procedures or delays in processing financial transactions accounted for a significant portion of the referred findings. Missing documents and/or unsigned documents accounted for the second highest number of findings. Other findings involved timekeeping and case management reporting.

This report will be presented to the Corporation's authorization and appropriations committees of Congress immediately and will be made available to the public not later than October 16, 2000.

E. R. Quatrevaux
Inspector General

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RESULTS

The Office of Inspector General (OIG) received 263 calendar year 1999 financial statement audit reports from LSC grantees. These reports contained 112 findings. The 56 findings listed below were significant and were referred to LSC management for follow up to ensure that the grantees corrected the reported problems. The remaining findings were not significant and were not referred to management (see page 3). One grantee denied its IPA access to records needed to do the audit. The issue was resolved and the IPA completed the audit and provided an unqualified opinion on the grantee's financial statements and compliance with LSC laws and regulations

Although the categories are not mutually exclusive and some findings could be listed in more than one category, the following summary of significant findings shows each finding in only one category for ease of reference.

Summary of Significant Findings Referred to Management **Grantee Audit Reports Calendar Year 1999**

<u>Category</u>	<u>Number of Findings</u>
Internal Control Problems.....	20
Processing financial data	
Weaknesses over cash receipts/disbursements	
Reconciliation of client trust accounts	
Procedures lacking or not followed	
Segregation of duties	
Property inventory not taken	
Uninsured bank deposits	
Missing documents and/or unsigned documents (i.e., client state- ment of facts, citizenship attestation, retainer agreements)	16
Reporting problems	7
Timekeeping procedural and systems deficiencies	5
Private Attorney Involvement requirements not met	5
LSC fund balance exceeded amount allowed by LSC regulations	3
Total	56

Noncompliance with Restrictions

The IPAs did not report any findings of noncompliance with either statutory client eligibility requirements (aside from documentation problems), or with the prohibitions and restrictions on the legal services that may be provided.

Internal Control Problems

Deficiencies in the internal control system accounted for the largest number of significant findings (20). These findings primarily involved the lack of written procedures, the failure to follow procedures when they were available, weaknesses in processing financial data, weaknesses in handling cash receipts, cash balances exceeding the amount insured by the Federal Deposit Insurance Corporation, insufficient staff to establish controls over client trust fund accounts, and property inventory not taken consistently. These findings were significant and were referred to management because an effective system of internal controls helps ensure compliance with LSC laws and regulations.

Missing Documents and/or Unsigned Documents

The second largest number of significant findings (16) was related to missing and/or unsigned documents such as client statements of facts, citizenship attestations, and retainer agreements. These findings were referred to LSC management because missing or unsigned documents can conceal noncompliance with statutory requirements or other reportable conditions.

Reporting Problems

Seven findings disclosed that grantee reports to LSC were inaccurate, late, or not submitted. Four of these findings related to errors in grantees' reporting of case statistical data. These findings were significant because accurate reporting is an important element of effective program management, and because LSC established case statistical data as a performance measure for reporting under the Government Performance and Results Act.

Timekeeping Procedural and Systems Deficiencies

Five findings reported deficiencies in timekeeping systems. These findings were significant because accurate and reliable timekeeping is essential to ensuring that grantee staff did not violate the prohibitions or restrictions imposed by Congress.

Private Attorney Involvement Requirements Not Met

Five findings related to the failure to meet established Private Attorney Involvement Requirements.

LSC Fund Balance Exceeded Amount Allowed by LSC Regulations

Three findings reported that grantees had LSC fund balances that were significantly in excess of the amount allowed by LSC regulations. The grantees had not received waivers from LSC to allow the funds to be retained. Excess fund balance findings are significant because they indicate that grantees may not be making the proper use of LSC funds.

Repeat Findings

Six of the above findings are repeat findings from the fiscal year 1998 audit reports. In these cases, the grantees did not correct, or only partially corrected the problems reported last year. The grantees did not provide reasonable explanations for their failure to correct previously reported problems.

Findings Not Referred To Management

The IPAs reported 56 additional findings in audit reports for 50 grantees. After reviewing these reports, the OIG concluded that the findings did not warrant mandatory follow-up by LSC management. Generally, the problems had been corrected or were considered not significant and were communicated to LSC management via the Audit Information Management System (AIMS). These findings were not significant for following reasons.

- (19) Minor internal control problem
- (15) Few insignificant errors in sample and problems not systemic
- (12) Minor omissions or discrepancies, i.e., document obtained and signed but undated
- (8) Corrective action taken subsequent to audit
- (2) Qualified audit opinion based on problems unrelated to LSC

Denial of Access

One grantee refused its auditor access to records for the 1999 audit. As a result, the IPA disclaimed an opinion on the grantees' compliance with LSC laws and regulations. The OIG rejected the compliance audit report and asked LSC management to suspend the recipient's funding until an acceptable audit was performed. Management accepted the recommendation and suspended funding. The recipient filed in the State Supreme Court a Verified Petition for Clarification of Attorney Responsibilities Under the Rules of Professional Conduct. The State Supreme Court subsequently issued an order declining jurisdiction over the matter and dismissing the petition. The recipient then provided its IPA access to the required records. The IPA performed the compliance audit and issued an unqualified opinion. The OIG accepted the report and recommended that management lift the funding suspension. Management agreed and funding was restored.

AUDIT REQUIREMENTS

Recipients of grants from the LSC are responsible for preparing annual financial statements and arranging for their audits by IPAs. These audits are to be conducted in accordance with Government Auditing Standards promulgated by the Comptroller General of the United States, Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions" and the "LSC Audit Guide for Recipients and Auditors." Audit reports must be submitted to the LSC Office of Inspector General (OIG) within 120 days of the recipients' fiscal year end. The reports are to include an opinion on the financial statements, a report on the internal control structure, a report on compliance with laws and regulations, and a management letter, when appropriate.

IPAs are also required to submit a Summary Report Form (SRF) on Noncompliance with Laws and Regulations, Questioned Costs, and Reportable Conditions. IPAs must submit SRFs via the Internet by completing a form residing on the OIG website. The SRF must be submitted regardless of whether or not there are any audit findings. The IPA reports on the SRF any instances of noncompliance, material reportable conditions and additional findings. For each reported findings, the IPA provides a description of the finding, Audit Guide identification code for the finding, the sample size of case files reviewed, the number of times a deficiency occurred, the recipient response to the finding, and the amount of any questioned costs.

Under certain circumstances, the recipient must submit to the OIG a special report, called a 5-day letter, which is based on a report the IPA prepares. IPAs must immediately report to the recipient all findings of noncompliance with the Congressionally imposed prohibitions and restrictions. The IPA's report describes the noncompliance and the circumstances under which it occurred. Within five business days after issuance of the IPA's report, the recipient must submit to the OIG, a report entitled "Recipient 5-day Special Report to the OIG on Noncompliance with Laws and Regulations." The recipient also sends a copy of this report to the IPA.

Recipients must submit corrective action plans to LSC for all material findings and recommendations and questioned costs the IPA identified, within 30 days of the audit report's submission. These plans must describe the corrective action taken or planned in response to the audit findings and recommendations. If the recipient disagrees with the findings and recommendations, the reasons for the disagreement must be fully explained. The recipient may incorporate the corrective action plans into the audit reports as part of its response to the auditor's findings and recommendations, but this option does not extend the due date for audit reports.

SCOPE AND METHODOLOGY

SCOPE

This report covers the grantee financial, internal control, and compliance audit reports prepared by IPAs for the year ended December 31, 1999.

METHODOLOGY

Audit Information Management System

The OIG developed the Audit Information Management System (AIMS) to support the audit review team in performing desk reviews of audit reports. The system tracks and collects information on the SRF, audit reports, 5-day letters, audit costs, and management letters. It also tracks the resolution of audit findings and recommendations and documents and grantee corrective actions.

Initial Processing

IPAs electronically submit the SRF. The OIG staff verifies that each form includes all required information before it is accepted into AIMS. The grantees submit the audit reports through the mail. The OIG staff does a brief review to ensure that reports on the financial statement, internal controls, and compliance LSC with laws and regulations are provided.

Focused Review

Following initial processing, the OIG conducts a focused review of the critical audit findings and recommendations that the IPA reported on the SRF. The OIG auditors can add findings that were not reported on the SRF and amend IPA reported findings based on the focused review. An auditor reviews the findings and recommendations and takes action to "invoke A-50" or to close the finding to inventory. The LSC grantee audit follow up process incorporates the concepts of OMB Circular A-50 "Audit Follow Up," and hence the use in AIMS of the term "invoke A-50." The auditor then writes a justification for the recommended action, which is approved or revised by OIG audit management.

If A-50 is invoked, OIG audit management refers the audit findings and recommendations to LSC management for follow up action. The referral is made

through AIMS by approving the finding for follow up and establishing a project code to track the follow up process through resolution and corrective action.

If the finding is closed to inventory, the findings and associated recommendations are retained in the AIMS system in an inventory of noncritical findings. These findings are provided to LSC management by the OIG for information and no follow up action is required. The IPAs follow up on these findings in the next fiscal year audit. If the IPAs report that these findings are uncorrected the second year, A-50 is invoked at that time.

The decision of whether to invoke A-50 or to close to inventory rests on the finding's significance. A significant finding requires management's attention based on quantitative and/or qualitative conditions contained in the finding. The following types of findings and recommendations by grantee IPAs are referred to LSC management for follow up action: noncompliance with laws and regulations which have a material impact on the LSC program, questioned or unsupported costs, material weaknesses, reportable conditions that are indicative of a systemic problem, and uncorrected findings from prior reports.

LSC management is responsible for following up on significant findings referred by the OIG to ensure that deficiencies and noncompliance are promptly resolved. Recipients are required to submit corrective action plans to LSC management no later than 30 days after submission of the audit report. If a recipient does not submit a corrective action plan by the due date, LSC management contacts the grantee and requires immediate submission of the plan.

Resolution

Resolution is the point at which LSC management agrees with the grantee's proposed corrective action plan or accepts the grantee's disagreement with a reported finding, and the OIG concurs in the management decision. If LSC management and the OIG cannot agree, resolution is reached when the LSC Audit Follow Up Official, designated by the LSC President, issues a decision on the matter.

LSC management reviews the grantee's corrective action plan to determine if it is satisfactory. If the proposed corrective action is unsatisfactory, LSC management communicates the deficiencies to the grantee and requires the grantee to provide a satisfactory plan.

LSC management ensures that proposed corrective actions are consistent with law, regulations, and LSC policy. If a grantee disagrees with a reported finding or recommendation, LSC management ensures that the grantee provides an adequate written justification containing the legal and factual basis for the disagreement. Within 30 days of receipt of the referred finding, LSC management notifies the OIG of its acceptance of the corrective action plan or the grantee's disagreement with the finding and recommendation.

The OIG notifies LSC management within 15 days of its concurrence or nonconcurrence. If the OIG concurs, the finding is considered resolved. If the OIG does not concur, the Audit Follow Up Official has 15 days to seek agreement between LSC management and the OIG. If no agreement is reached within the 15 days, the Audit Follow Up Official issues a decision within 7 days, and the finding is considered resolved.

Corrective Action

After resolution has been obtained, LSC management ensures that corrective actions have been taken by the grantee within six months of the resolution date. LSC requires the grantee to provide documentation that the corrective action has been fully implemented and requires the grantee to certify that all corrective actions have been implemented. LSC management notifies the OIG of all completed corrective actions and provides the OIG with copies of the grantee certifications. Upon receipt of the notification of completion, the OIG closes the respective findings and recommendations. IPAs will also verify completion of corrective actions during the next fiscal year audit.

Quality Control Process

In 1998, the OIG initiated the Audit Service Review (ASR) program to evaluate the effectiveness of the compliance audits performed by grantees' IPAs. ASRs include a review of the IPAs' working papers to determine if the grantees' compliance with LSC laws and regulations was adequately tested. The OIG conducted 30 ASRs on the grantees' 1999 audits. One ASR determined that the IPA did not adequately test the grantee's compliance with LSC laws and regulations. The OIG required the auditor to redo the audit and perform adequate testing. Several other ASRs disclosed that the auditors did not adequately test one or two regulations. In these cases the OIG concluded that the deficiencies were relatively minor and required the auditors to ensure that adequate testing would be done on future audits. The continuing ASR process allows the OIG to monitor the quality of the IPA audit reports and thus increase the reliability of the reports.

The OIG reviews all audit reports submitted by IPAs that include critical findings and those that have management letters. The audit reports prepared by IPAs selected for ASRs are also reviewed. The OIG reviewed 129 of the 263 audit reports received for Calendar Year 1999. In prior years, a sample of reports lacking critical findings was reviewed. These reviews disclosed few critical findings that had not been reported and were, therefore, not cost effective. Reports lacking critical findings or a management letter were not a priority this year and such reports have not been reviewed. As staff is available, a small sample of reports with noncritical findings will be reviewed.